AMERICAN BANKRUPTCY INSTITUTE

2019 Caribbean Insolvency Symposium

Caribbean Track

Strategic Use of Independent Directors in Multi-Jurisdictional Insolvency Proceedings

Katherine R. Catanese, Moderator
Foley & Lardner LLP; New York

Joel E. Cohen
Stout Risius Ross, LLC; New York

Casey McDonald
Calderwood; Grand Cayman, Cayman Islands

Michael Pearson
FFP (Cayman) Ltd.; Grand Cayman, Cayman Islands

Rachael Reynolds
Ogier; Grand Cayman, Cayman Islands

CONCURRENT SESSION

2019

ABI CARIBBEAN INSOLVENCY SYMPOSIUM
January, 2019

The Strategic Use and Dynamics of Independent Directors Through Multi-Jurisdictional Insolvency Proceedings

1. Introduction
    a. The panel will explore the roles, responsibilities, benefits and liability to utilizing independent directors through the various stages of the life of a company / investment fund. Additionally, the panel will explore case studies to show the use of independent directors in multi-jurisdictional insolvency proceedings.
    b. Duties of an Independent Director
    c. Conflicts that Arise
    d. Jurisdictional awareness

2. Company/fund formation and "Going Concern" stages
    a. Across Jurisdictions
    b. Risks
    c. MATERIALS:
        - CIMA: Statement of Guidance for Regulated Mutual Funds
3. Asset Recovery
    a. How can an independent director help?
    b. How can an independent director guide company/fund away from insolvency?
    c. MATERIALS:
        - Sino Clean Energy: Lower Court and 9th Circuit Opinions
4. Insolvency
    a. Roles
    b. Responsibilities
    c. Risks
    d. MATERIALS:
        - Nine West Article – October 2018
        - *Directors Duties in the Zone of Insolvency*
5. Restructuring / Emergence
    a. Changing roles of directors
    b. Existing directors
    c. Independent directors
    d. Restructuring directors
        - Pros and cons of hiring restructuring directors (not really yet proven as a concept)
        - Skill/experience gaps

6. Final Thoughts/Questions

NEWS YOU SHOULD KNOW:

THOSE OF YOU WHO ADVISE CORPORATE DIRECTORS, this News You Should Know is for you. Below is a snapshot of the shifting duties for boards of directors during the zone of insolvency.

Directors Duties in the Zone of Insolvency (and How Directors Can Protect Themselves)

- Zone of insolvency: Insolvency means that the corporation is not able to pay its debts and/or its liabilities exceed it assets. But insolvency is not always clear and facts can change rapidly. Courts refer to this uncertainty when the corporation is in financial distress but its insolvency is unclear as the corporation being in the "zone of insolvency."

- If a corporation falls within the zone of insolvency, directors may owe fiduciary duties to the corporation, its shareholders and the corporation's creditors, although the duties of a director when the corporation is insolvent or in the zone of insolvency depend on state law. For example, Delaware has continuously held that directors do not owe a duty to creditors when the corporation is in the zone of insolvency. *See Quadrant Structured Products Co. Ltd. v. Vertin,* 115 A.3d 535 (Del. Ch. 2015) (collecting cases and holding that a directors' duties always run to the corporation and these duties only run to the creditors of the corporation after the corporation actually becomes insolvent—not when the corporation is in the zone of insolvency).

- However, other states are not as lenient and hold that a corporation's directors do have fiduciary duties to creditors when the corporation is in the zone of insolvency. *See*, for example, *Gladstone v. Stuart Cinemas, Inc*., 878 A.2d 214, 224-25 (Vt. 2005) ("[t]he duty to creditors applies not only when the corporation is technically insolvent, but also when the corporation operates in the vicinity or zone of insolvency").

Regardless of which state law applies, because it is sometimes unclear where the "zone of insolvency" starts and where "insolvency" begins, a corporation should take steps to protect the directors against accusations that their actions were to the detriment of the corporation's creditors, regardless of which state law applies. The board should:

- Abstain from declaring any shareholder dividends or other corporate distributions or paying bonuses or increases in compensation.

- Scrutinize any corporate action intended to give stockholders preferential treatment to the detriment of impairing creditors (and their security).

- Be attentive and engaged (and documentation should show this), meeting weekly or bi-weekly if appropriate.

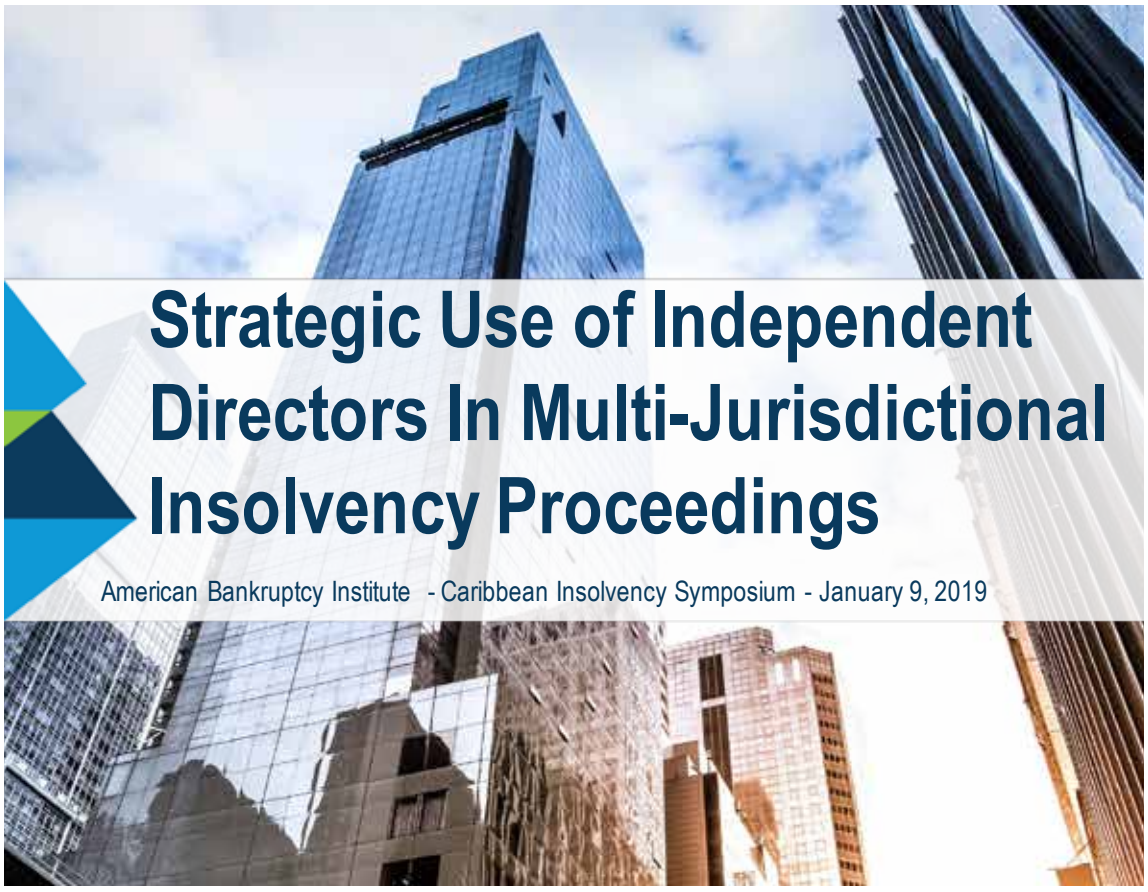
- Thoroughly document discussions and diligence taken in making business decisions.

- Avoid entering into conflict of interest transactions with the corporation (or transactions in which there is a perception of conflict).

4819-2396-0872.2

- Document sales of assets and make sure all are at arm's length.
- Engage competent legal counsel to review and assist in documenting corporate actions.
- Review the D&O insurance policy to be familiar with coverage when the corporation is in the zone of insolvency.
- Continue to pay taxes—in some cases, officers and directors can be liable for payment.

Takeaway: The line between when a corporation is insolvent or in the zone of insolvency may be hard to ascertain. Therefore, although states differ as to whether directors can be sued for breaches of fiduciary duty for decisions made while the corporation is in the zone of insolvency, directors should take certain precautions, as described above, if such potential exists, especially if the decisions are risky or not in the best interest of the corporation.



Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

American Bankruptcy Institute - Caribbean Insolvency Symposium - January 9, 2019

Panelists

FOLEY & LARDNER LLP

Katie R. Catanese
Moderator
Foley and Lardner
New York, NY

CALDERWOOD

Casey McDonald
Calderwood
Grand Cayman

Ogier

Rachael Reynolds
Ogier
Grand Cayman

FFP

Michael Pearson
FFP
Grand Cayman

STOUT

Joel E. Cohen
Stout
New York, NY

Independent Directors

Role

Responsibility

Risk

3

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

What Is An Independent Director?

ROLE

Non-conflicted, non-employee, non-manager, receives no income from the company other than his or her director fee

No legal distinction in obligations of IDs and other directors

OBJECTIVE/GOAL

Contribute to the governance process of the company and evaluate best interests of the company

CONFLICT FREE

No substantial capital invested and no contractual obligations or ties to the company or its principals

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

Applicable Principles

- Duties owed to the company as a whole rather than to individual shareholders or classes of shareholders
- The fiduciary duties extend to the company's creditors in the zone of insolvency and owed to creditors ahead of shareholders once insolvent
- Directors can 'contract out' of certain fiduciary duties (never out of duty of good faith)
- Directors not obliged to 'get it right' – expected to make commercial decisions and court will be slow to intervene

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

Duties

- **Fiduciary duties**
  - A director must act loyally, honestly and in good faith in the best interests of the company.
  - A director must avoid any conflict of duty and interest.
  - A director must exercise his powers for a proper purpose.
  - A director must not fetter the future exercise of his powers.
- **Common law duties** of care, diligence and skill.
- **Statutory duties**

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

3 Scenarios:

- **In a corporate distress/litigation situation**
- **To oversee a particular transaction**
- **Restructuring**

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

3 Scenarios:

1. In a corporate distress situation

- solvency
- zone of insolvency and insolvency
- litigation

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

3 Scenarios:

2. To oversee a particular transaction.

- Scrutiny of difficult or controversial decision which a company needs to make
- existing director with a conflict
- stalemate

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

3 Scenarios:

3. Restructuring

- creditor requires use of ID as a condition of restructuring/forbearance
- to assist in resolving conflicts of interest with debtors particularly when there are multiple debtors

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

Practical Considerations

- Not required to give continuous attention
- Not required to have technical expertise
- Mistakes not necessarily a breach

BUT…

- Not enough to simply attend quarterly meetings
- Satisfy self of appropriate delegations and regular meetings with delegates
- Proper understanding of business, financials and portfolio of assets
- Review strategy and objective in offering documentation and compliance

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

Practical Considerations

- Powers of independent director
  - make sure the ID has the necessary powers
  - ensure consistency between constitutional documents / deeds of indemnity / engagement terms / DSA / side letters
- Indemnity and Exculpation
  - consistency of documentation
  - advancement provisions
- Insurance
  - yes or no?

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

Practical Considerations

- Keep the position under review:
  - has there come a time when it is appropriate for liquidators/receivers to be appointed?
  - should IDs resign?
- Remember to whom duties owed
  - independence
  - no allegiance to those responsible for the appointment.
  - information should be derived from all stakeholders
  - requires a significant amount of diplomacy as well as integrity.

1

Strategic Use of Independent Directors In Multi-Jurisdictional Insolvency Proceedings

Take Aways

- Use of IDs can be an effective tool:
  - in corporate distress situations to avoid winding up / litigation
  - to avoid disputes in respect of controversial transactions/decisions;
    - to protect against potential allegations of breach of duties
    - comfort to stakeholders of independent scrutiny
  - to avoid substantial costs to prevent costs of insolvency and/or litigation

1

Any Questions?

Katie R Catanese
KCatanese@foley.com

Casey McDonald
cmcdonald@Calderwood.ky

Rachael Reynolds
Rachael.Reynolds@ogier.com

Michael Pearson
Michael.pearson@ffp.ky

Joel E Cohen
jcohen@stout.com

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE SINO CLEAN ENERGY, INC., *Debtor.*	No. 17-15316
SINO CLEAN ENERGY, INC., acting by and through BAOWEN REN, PENG ZHOU, WENJIE ZHANG, ZHIXIN JING, and PAUL CHUI; and HUIQIN CHEN, LI HAN, GUANGJON HUANG, XIAODONG JIANG, XUELING JING, YUFENG LI, HAICHO LI, LANYING LI, LIANG WANG, ZHEN WU, TING XTE, HESHUN YANG, CHUNYUN ZHANG, TIEKUAN ZHANG, personally and as shareholders, *Plaintiffs-Appellants*, v. ROBERT W. SEIDEN, in his capacity as Receiver over Sino Clean Energy Inc., *Defendant-Appellee.*	D.C. No. 2:15-cv-01781-JAD OPINION

Appeal from the United States District Court
for the District of Nevada
Jennifer A. Dorsey, District Judge, Presiding

Argued and Submitted July 9, 2018
San Francisco, California

Filed August 27, 2018

Before: Susan P. Graber and Richard C. Tallman, Circuit Judges, and Ivan L.R. Lemelle,* Senior District Judge.

Opinion by Judge Lemelle

SUMMARY**

Bankruptcy

The panel affirmed the district court's affirmance of the bankruptcy court's dismissal of a Chapter 11 bankruptcy petition filed by former board members of a corporation.

The panel held that the former board members lacked corporate authority under Nevada law when they filed the bankruptcy petition because a receiver appointed by the Nevada state court already had removed them from the corporation's board of directors. Accordingly, the former board members were not authorized to file the bankruptcy petition on behalf of the corporation.

* The Honorable Ivan L.R. Lemelle, Senior United States District Judge for the Eastern District of Louisiana, sitting by designation.

** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

COUNSEL

Matthew C. Zirzow (argued), Larson & Zirzow LLC, Las Vegas, Nevada, for Plaintiffs-Appellants.

Katherine R. Catanese (argued) and Douglas E. Spelfogel, Foley & Lardner LLP, New York, New York; Ryan J. Works, McDonald Carano LLP, Las Vegas, Nevada; for Defendant-Appellee.

OPINION

LEMELLE, Senior District Judge:

Former board members of Sino Clean Energy, Inc. (collectively, "Appellants"), appeal the district court's order affirming the bankruptcy court's dismissal of their Chapter 11 bankruptcy petition. The bankruptcy court dismissed the petition because it found that the petition lacked the requisite authority from the corporation's board of directors. The district court agreed, ruling that the individuals attempting to file the petition lacked authority where a receiver appointed by the Nevada state court already had removed them from the corporation's board of directors. We affirm. The bankruptcy court correctly dismissed the action because Appellants lacked corporate authority when they filed the rogue bankruptcy petition.

BACKGROUND AND PROCEDURAL HISTORY

Sino Clean Energy, Inc. ("SCEI"), is a Nevada holding company that, through various subsidiary entities, produces coal-water slurry in China. SCEI wholly owns Wiscon Holdings Limited which, in turn, owns 100% of the interests

in Tongchuan Suoke Clean Energy Company. Both subsidiaries are entities of the People's Republic of China.

Until the legal troubles described here, SCEI had been under control in major part by former chairman and CEO Baowen Ren. Starting in 2011, SCEI became the subject of much legal controversy. In May 2012, the Securities and Exchange Commission deregistered SCEI after it abruptly stopped filing certain required forms and financial information. In September 2012, SCEI was suspended from the NASDAQ stock exchange.

By October 2013, a group of forty-three shareholders had filed a Nevada state-court petition in an attempt to acquire financial information from SCEI, including books and records regarding the money invested with SCEI. The shareholders also sought certain declaratory relief under Nevada Revised Statute section 78.345. SCEI was properly served with the complaint, but SCEI opted not to offer any responsive pleadings in the Nevada state-court action. After more than a year of SCEI's disregard for the Nevada state-court action, the plaintiffs filed for entry of default, which the state court granted. A few months after an entry of default, on March 17, 2014, the shareholder plaintiffs filed a motion for the appointment of a receiver. The Nevada state court granted the motion on May 12, 2014.

The order appointing a receiver held that SCEI, through its board of directors (at that time), was liable for nonfeasance and gross mismanagement pursuant to Nevada Revised Statutes section 78.650. After finding that SCEI's board of directors "failed to properly manage SCEI's affairs," the state court appointed a receiver and granted him many powers, including the power to reconstitute SCEI's board of directors. The receiver eventually replaced the

SCEI board of directors, effective in December 2014, with current and sole director, Gregg Graison.

In July 2015, former chairman and CEO Ren purported to "reconstitute" the former SCEI board of directors, and thereafter attempted to file a voluntary petition for Chapter 11 bankruptcy on behalf of SCEI. The bankruptcy court dismissed the action on August 26, 2015, holding that, at the time the petition was filed by Ren and the former board members, the petition "was filed without corporate authority" because SCEI's board of directors "had been replaced by the Receiver." The district court affirmed.

STANDARD OF REVIEW

We review de novo the district court's decision on an appeal from bankruptcy court. *Educ. Credit Mgmt. Corp. v. Coleman (In re Coleman)*, 560 F.3d 1000, 1003 (9th Cir. 2009). "We apply the same standard of review to the bankruptcy court decision as does the district court: findings of fact are reviewed under the clearly erroneous standard, and conclusions of law, de novo." *Id*. (internal quotation marks and brackets omitted).

DISCUSSION

The Bankruptcy Code defines the term "petition" to mean a "petition filed under section 301, 302, 303 and 1504" of the Act. 11 U.S.C. § 101(42). A voluntary petition for bankruptcy under § 301 is commenced by the filing of a bankruptcy petition by an entity that may be a debtor. *Id.* § 301. State law determines who has the authority to file a voluntary bankruptcy petition on behalf of a debtor. *Price v. Gurney*, 324 U.S. 100, 106–07 (1945); *see also Keenihan v. Heritage Press, Inc.*, 19 F.3d 1255, 1258 (8th Cir. 1994) (*"*A person filing a voluntary bankruptcy petition on a

corporation's behalf must be authorized to do so, and the authorization must derive from state law.").

The corporation involved here, SCEI, was formed under Nevada state law, which vests decision-making authority in a corporation's current board of directors. *See* Nev. Rev. Stat. § 78.315. In regard to actions taken by a Nevada corporation,

> [u]nless the articles of incorporation or the bylaws provide for a greater or lesser proportion, **a majority of the board of directors** of the corporation **then in office**, at a meeting duly assembled, is **necessary** to constitute a quorum **for the transaction of business**, **and the act of directors holding a majority of the voting power** of the directors, present at a meeting at which a quorum is present, is the act of the board of directors.

Id. § 78.315(1) (emphases added). The statute also provides that action may be taken with "written consent" that is "signed by all the members of the board," in lieu of a meeting. *Id*. § 78.315(2). Nevada state law includes the decision of its state courts. *Tenneco W., Inc. v. Marathon Oil Co*., 756 F.2d 769, 771 (9th Cir. 1985). Applying Nevada law to the facts in the record, the individuals who filed the bankruptcy petition were not members of the board of directors of SCEI at the time they filed the petition, and they were not authorized to file a bankruptcy petition on behalf of SCEI.

Our decision in *Oil & Gas Co. v. Duryee*, 9 F.3d 771 (9th Cir. 1993), is directly on point. In *Duryee*, an Ohio state court placed Oil & Gas Insurance Company into

rehabilitation and appointed a rehabilitator. *Id*. at 772. The bankruptcy court ultimately dismissed a petition pursuant to the Bankruptcy Code's preclusion of insurance companies' ability to seek bankruptcy relief. *Id*. Nevertheless, an "initial difficulty" for us was deciding **who** the appellant was. *Id*. at 773. We ruled that, pursuant to the rehabilitation order, the rehabilitator was the only person authorized to commence bankruptcy proceedings on behalf of Oil & Gas. *Id*. As a result, we held that the individual not authorized by the rehabilitation order who was purporting to file bankruptcy on behalf of the corporation was an "impostor," and the action was "null and void" as "fraudulently filed." *Id*. That same logic applies in this instance.

In asserting a contrary conclusion, Appellants rely heavily on *In Re Corporate & Leisure Event Prods., Inc.*, 351 B.R. 724 (Bankr. D. Ariz. 2006). To the extent that *Corporate & Leisure* contradicts our decision in *Duryee*, it is wrong. No matter the equitable considerations, state law dictates which persons may file a bankruptcy petition on behalf of a debtor corporation. We understand *Corporate & Leisure* as announcing the more limited holding that, where a state court purports to enjoin a corporation from filing bankruptcy altogether, federal law preempts that injunction. Here, however, SCEI was and is fully able to file for bankruptcy through valid filings made by its eligible board of directors. *Corporate & Leisure* is inapposite.

AFFIRMED.

UNITED STATES DISTRICT COURT

DISTRICT OF NEVADA

SINO CLEAN ENERGY INC., acting by and through BAOWEN REN, PENG ZHOU, WENJIE ZHANG, ZHIXIN JING, and PAUL CHUI; and HUIQIN CHEN, LI HAN, GUANGJON HUANG, XIAODONG JIANG, XUELING JING, YUFENG LI, HAICHO LI, LANYING LI, LIANG WANG, ZHEN WU, TING XTE, HESHUN YANG, CHUNYUN ZHANG, TIEKUAN ZHANG,

Appellants

v.

ROBERT W. SEIDEN, ESQ., in his capacity as Receiver over Sino Clean Energy Inc.,

Appellee

2:15-cv-01781-JAD

Bankruptcy No. BK-S-15-14261-BTB

Order Affirming Bankruptcy Court Decision

Appellants are former directors of Sino Clean Energy Inc. They filed for bankruptcy on behalf of Sino, the bankruptcy court dismissed their petition, and they now appeal. In dismissing, the bankruptcy court reasoned that only a corporation's current board of directors can file for bankruptcy—and here, at the time the appellants filed, a state-appointed receiver had already removed them from their director positions for mismanaging the company. Because Sino's new board of directors had not authorized the filing, the bankruptcy court dismissed its petition. On appeal, the appellants contend that federal law preempts any state law (including a state receiver) that restricts a company's directors from filing for bankruptcy—and that Sino's former directors therefore retained the ability to file despite their ousting by the receiver.

The appellants' argument blurs the line between two related—but distinct—rules: the rule preventing states from barring *corporations* from filing for bankruptcy, and the longstanding rule empowering states to bar *certain individuals* from making that decision for a corporation. I decline their invitation to extend the rule that states cannot bar corporations from the bankruptcy courts to also mean that states cannot prevent certain individual directors from being the ones who decide whether the corporation may file—a question that has always been left to the states. The bankruptcy

system is just as available to Sino now as it was before the receiver was appointed; only the identity of the person making that decision for Sino has changed. I thus affirm the bankruptcy court's dismissal.[1]

Background

A. Sino was forced into receivership, and the receiver replaced the appellants with new board members.

Sino is a holding company for various entities in China that produce coal-water slurry—an alternative fuel that it claims burns cleaner than traditional coal. Starting in 2011, Sino became embroiled in sundry U.S. litigations (including at least a defamation case and a class action).[2] Sino's shareholders eventually asked a Nevada court to appoint a receiver to take over Sino's affairs, fearing that the appellants would mismanage the company into insolvency.[3]

Although they were served with the shareholder's complaint, the appellants never responded to the state action. The state court entered an order (1) appointing a receiver and (2) finding that the appellants were liable for grossly mismanaging Sino.[4] The state court's order empowered the receiver to pick a new board of directors for Sino and to take control of Sino's property.[5]

The receiver attempted to work with the appellants, but to no avail. In 2014, the receiver replaced the appellants in their board positions with a new board of directors.[6] It does not appear

---

[1] I find this motion suitable for disposition without oral argument. Nev. L.R. 78-1.

[2] ECF No. 11 at 138–39.

[3] *Id.*

[4] *Id.* at 164–68.

[5] *Id.*

[6] *Id.* at 140. Technically, the receiver replaced the board with a single director, Gregg Graison. The record supports the conclusion that Graison was properly installed as Sino's president, vice president, secretary, treasurer, and sole director. *Id*; *see also id.* at 256 (Graison's resolution as "sole member of the company" memorializing Graison's appointment as sole director); *id.* at 258 (listing of officers showing Graison as sole director of Sino as of December 2014).

that the appellants have cooperated with Sino's new board or the receiver since.[7]

Then in the summer of 2015—more than a year after the receiver took over (and seven months after the new board was in place at Sino)—appellants filed a bankruptcy petition on behalf of Sino.[8] Sino's then-current board passed a resolution directing that the bankruptcy petition be withdrawn.[9]

B. The bankruptcy court dismissed this case because appellants were no longer Sino's directors, and thus they lacked authority to file for bankruptcy on behalf of the company.

Shortly after the bankruptcy case started the receiver moved to dismiss, arguing that the appellants had no authority to file for bankruptcy on behalf of Sino because they were no longer its directors. After a lengthy oral argument, the bankruptcy judge provided a thorough decision from the bench, granting the receiver's motion to dismiss.[10]

The bankruptcy court held that Sino's board of directors had in fact been replaced before the appellants filed their bankruptcy petition.[11] The court concluded that the case must be dismissed because only a corporation's current directors can act on its behalf, and the appellants (as former directors) therefore had no authority act for Sino. The court relied heavily on the Ninth Circuit case of *Oil & Gas Co. v. Duryee*, 9 F.3d 771 (9th Cir. 1993). The ousted board appeals.

Discussion

A. Standard of Review

I review a bankruptcy court's decision to dismiss for abuse of discretion and apply a two-part

---

[7] For example, there is evidence the appellants failed to respond to the receiver's requests for information. *Id.* at 141. Later, at least one of the appellants communicated with the receiver, but it appears that he failed to follow up. *Id.* In fact, the receiver has filed a motion in the state-court action to hold this director in personal contempt. *Id.*

[8] *Id.* at 145.

[9] *Id.* at 256.

[10] ECF No. 15 at 201.

[11] *Id.*

test.[12] I consider de novo whether the court applied the correct legal standard.[13] But I review the bankruptcy court's findings of fact for clear error.[14] A fact finding is only clearly erroneous "if it was without adequate evidentiary support or was induced by an erroneous view of the law."[15] I "may not simply substitute [my] view" for that of the bankruptcy court.[16] Finally, I may affirm on any basis supported by the record.[17]

B. The bankruptcy court properly dismissed this case because the appellants had no authority to file for bankruptcy on behalf of Sino.

This case turns on a single issue: Do the appellants have authority to file for bankruptcy on Sino's behalf? An important starting principle is that state law—not federal law—governs whether a person is authorized to file a bankruptcy petition on behalf of a corporation.[18] This fact reflects a preference for allowing states to make judgments about who should, and who should not, make the important decision of whether a corporation should for bankruptcy. Indeed, the Supreme Court has been clear on this point: "If the District Court finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition."[19] Bankruptcy courts have no jurisdiction to "determine that those who in fact do not have the authority to speak for the corporation as a matter of local law are entitled to be given such authority and therefore should be empowered to file a petition on behalf of

---

[12] *Leavitt v. Soto,* 171 F.3d 1219, 1223 (9th Cir. 1999).

[13] *Id.*

[14] *Id.*

[15] *Wall St. Plaza, LLC v. JSJF Corp.*, 344 B.R. 94, 99 (B.A.P. 9th Cir. 2006).

[16] *Barrera v. W. United Ins. Co.*, 567 F. App'x 491, 493 (9th Cir. 2014) (*citing U.S. v. Hinkson*, 585 F.3d 1247, 1262 (9th Cir. 2009).

[17] *Heilman v. Heilman*, 430 B.R. 213, 216 (B.A.P. 9th Cir. 2010).

[18] *Price v. Gurney*, 324 U.S. 100, 107 (1945).

[19] *Id.* at 106; *see also Tenneco West, Inc. v. Marathon Oil Co.*, 756 F.2d 769, 771 (9th Cir. 1985); *In re Licores*, No. SA 13-10578-MW, 2013 WL 6834609, at *5 (C.D. Cal. Dec. 20, 2013).

the corporation."[20]

Appellants do not meaningfully dispute that Nevada law precludes them from filing for bankruptcy on behalf of Sino.[21] After all, Nevada law vests the authority to make important decisions (including whether to file for bankruptcy) in a corporation's *current* board of directors. And at the time the appellants filed their bankruptcy petition in this case, the state-appointed receiver had ousted them from their board positions and installed a new board for Sino. Nor do the appellants dispute that Sino's new board (in power at the time of the bankruptcy filing) opposed the filing. This would thus seem an easy case: Sino's new board was the only one under Nevada law who could decide whether to file bankruptcy; Sino's old board (the appellants) were powerless to file their petition and it was properly dismissed.

But appellants contend that federal bankruptcy law preempts a state-appointed receiver from preventing a corporation's directors from filing for bankruptcy by replacing them with new directors. The appellants primarily rely on a single bankruptcy case from the District of Arizona, *In re Corporate and Leisure*.[22] And indeed, in a lengthy decision, the Arizona bankruptcy court held that federal law preempts a "receivership order that attempts to preclude any of the original constituents of the organizational entity from filing a petition on its behalf"—including by, as was the case here, replacing the corporation's board with a new one.[23] But *Corporate and Leisure* is an outlier, and I find its reasoning unpersuasive.

In reaching its holding, the *Corporate and Leisure* court largely relied on cases holding that state receivers cannot outright bar a corporation itself from filing for bankruptcy, which is not

---

[20] *Price*, 324 U.S. at 107.

[21] Appellants do not argue in their opening brief that the bankruptcy court's finding that Sino's board had been replaced was clearly erroneous.

[22] *In re Corp. & Leisure Event Prods., Inc.*, 351 B.R. 724 (Bankr. D. Ariz. 2006).

[23] *Id.*

helpful here given that Sino's new board can still file for bankruptcy should it choose to do so.[24] Appellants' other cited cases address the same rule.[25] At bottom, both the court in *Corporate and Leisure* and the appellants appear to be blurring the line between the rule preventing states from barring corporations from bankruptcy court, and the longstanding rule *empowering states* to determine who gets to file for bankruptcy in the first place.[26] Appellants provide no rationale for

---

[24] The court cited to a handful of cases that hold that states cannot prevent "an entity" from filing for bankruptcy relief; it cited no decisions holding that state law, or a state–appointed receiver, cannot determine which individual directors can file. *See id.* at 731. For example, the court cites to *In re Klein's Outlet, Inc.*, 50 F.Supp. 557, 559 (S.D.N.Y. 1942), which held that the mere fact that a receiver was appointed did not prevent the directors from filing for bankruptcy. *See also Cash Currency Exchange, Inc. v. Shine*, 762 F.2d 542, 552 (7th Cir. 1985) (holding that a receiver's appointment "is irrelevant to the determination whether a *particular entity* may file for bankruptcy relief" (emphasis added)); *Larson v. Kreisers, Inc.*, 112 B.R. 996, 998 & 1000 (Bankr. D.S.D. 1990) ("The court . . . has not unearthed any statutory or decisional law to support the contention that a state court receivership generally bars bankruptcy filing."); *In re S & S Liquor Mart, Inc.*, 52 B.R. 226, 227 (Bankr. D.R.I. 1985) ("[I]t is fundamental that a state court receivership proceeding may not operate to deny a corporate debtor access to the federal bankruptcy courts.").

[25] I agree that states cannot outright bar corporations from filing for bankruptcy. Not only do legion cases say so, but I have little doubt that Congress's sweeping bankruptcy laws would preempt state-law remedies that keep a corporation from the federal bankruptcy system.

[26] Nor do I find the Arizona bankruptcy court's reasoning otherwise helpful. The court stated that whether the receiver has the power to file for bankruptcy did not change the analysis, because Congress intended bankruptcy relief to be for the benefit of not just the creditors (who initiate the receivership) but others, such as the shareholders. *In re Corp. & Leisure Event Prods., Inc.*, 351 B.R. at 732. This implies that a receiver may not adequately represent the interests of a corporation's shareholders and therefore cannot be trusted to decide whether to file for bankruptcy on behalf of a corporation. But here, it is the new board that would decide whether to file, not the receiver. And in any event, under Nevada law, a receiver must make decisions in the shareholders' best interest, just as the board of directors does—so there does not appear to be a problem of adverse incentives. *See* NEV. REV. STAT. § 78.635 (stating that receivers represent shareholders, and that the receiver can settle with a creditor only if "deem[ed] just and beneficial to the corporation"). The state-court order in this case also required the receiver to "maximize value for all shareholders." ECF No. 11 at 164. Perhaps this case would be different if appellants could show that a receiver was biased or significantly delayed in appointing a new board, thus interfering with the corporations' ability to get into bankruptcy court in a timely matter. But that is not the case. The receiver appointed a new board almost a year before the appellants filed this rogue bankruptcy petition.

The court in *Corporate and Leisure* also reasoned that Congress must have intended to let bankruptcy courts settle disputes between receivers and directors because it gave bankruptcy courts

treating a state-appointed receiver any differently from other state laws defining who can file for bankruptcy on behalf of a corporation.

The only relevant Ninth Circuit precedent suggests that states are free to allow receivers to decide which members of a company's management can file for bankruptcy. In *Oil & Gas v. Duryee*, Judge Kozinski explained that once a state gives control of a corporation over to a third-party trustee (in that case a rehabilitator)—that is the "only person . . . who could go to court on behalf" of the corporation.[27] In *Duryee*, that meant that a corporation president's attempt to file for bankruptcy was "null and void."[28]

A recent bankruptcy case from the Central District of California is even more on point.[29] In *In re Licores*, the court held that a company's former partners could no longer file for bankruptcy once a state-appointed receiver had ousted them from their management positions.[30] The court explained that there is a difference between a state preventing *certain directors or partners* from filing for bankruptcy, which the state can do—and a state preventing a *corporation itself* from filing for bankruptcy, which the state cannot do.[31] The court rejected the argument that a state court "cannot divest the [directors of the company] from commencing a bankruptcy proceeding because it runs contrary to Congress's intent to enact uniform laws of bankruptcy."[32] It explained that "the

---

equitable power over property held by state receivers. *See* 11 U.S.C. § 543(b)(2); *Dill v. Dime Sav. Bank*, 163 B.R. 221, 225 (E.D.N.Y. 1994). But the fact that bankruptcy courts have equitable power to turn property over to a receiver says nothing about a bankruptcy court's power to decide who can file for bankruptcy.

[27] *Oil & Gas Co. v. Duryee*, 9 F.3d 771, 773 (9th Cir. 1993).

[28] *Id.* *Duryee* is arguably dicta on this point because the underlying debtor could not file for bankruptcy in the first place. That said, I find the decision's language helpful in predicting how the Ninth Circuit would rule on this issue.

[29] *In re Licores*, No. SA 13-10578-MW, 2013 WL 6834609, at *5 (C.D. Cal. Dec. 20, 2013).

[30] *Id.*

[31] *Id.*

[32] *Id.*

Receivership Order . . . [did] not divest the Debtor [of] its power to seek bankruptcy protection; rather, the order identifies who has the power to file the bankruptcy petition on behalf of Debtor."[33]

Ultimately, the weight of authority suggests two relevant principles: (1) states are empowered to determine who is best suited to make business decisions for a corporation; but (2) states cannot significantly interfere with a corporation's access to the bankruptcy system. The bankruptcy court's determination here that the appellants had no authority to file for bankruptcy aligns with both of these principles. A Nevada court determined that the appellants were committing misfeasance and could no longer be trusted to make decisions for Sino. So the state-appointed receiver picked a new board to make the corporation's decisions. There is no sensical reason to conclude that the appellants cannot be trusted to make any important business decision for Sino—but at the same time, federal law requires that they must be trusted to make the critical decision about whether to file for bankruptcy.[34] There is no evidence that either the receiver or the new board cannot file for bankruptcy on behalf of Sino, so there is no bar between Sino and the bankruptcy-court system that might trigger federal preemption.[35] I thus affirm the bankruptcy court's dismissal.[36]

---

[33] *Id.* The only cases I have found that hold that a receiver cannot interfere with a *former* board's ability to file for bankruptcy are premised on the idea that receivers cannot file for bankruptcy (so that by barring the directors, the receiver is practically barring the company altogether). *See, e.g., In re Prudence Co.*, 79 F.2d 77, 80 (2d Cir. 1935). Those cases are unhelpful because, here, a new board was installed (and thus whether the receiver could file does not matter). They are also unhelpful because it appears that the modern trend is to allow receivers to file for bankruptcy. *See, e.g., JY Creative Holdings Inc. v. McHale*, No. 14-2899, 2015 WL 541692 (M.D. Fla. Feb. 10, 2015).

[34] Filing for bankruptcy brings obvious benefits and challenges for a corporation, and the decision to file is thus not a trivial one.

[35] Nothing in the receivership order suggests that the receiver or new board cannot file for bankruptcy. Nor have appellants argued that they cannot. Appellants also argue that the bankruptcy filing was ratified later by the appellants themselves. But the same problem remains that the appellants are no longer Sino's board of directors.

[36] Appellants also argue that the appellee's brief should be struck because he does not have authority, as a receiver, to appear. I need not look to the receiver's briefing to see that appellants' arguments fail and that the bankruptcy court was right to dismiss this case. Regardless, receivers have standing in an appeal. *In re Licores*, 2013 WL 6834609, at *3 (C.D. Cal. Dec. 20, 2013) ("[A]nyone who has a legally protected interest that could be affected by a bankruptcy proceeding is entitled to assert that

Conclusion

Accordingly, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the bankruptcy court's decision is **AFFIRMED**. The Clerk of Court is directed to close this case.

Dated this 23rd of January, 2017.

Jennifer A. Dorsey
United States District Judge

interest with respect to any issue to which it pertains.").

December 2013

Statement of Guidance for Regulated Mutual Funds

Corporate Governance

Statement of Objectives

1.1 The Authority expects the oversight, direction and management of a regulated mutual fund, as defined by the Mutual Funds Law (2013 revision) to be conducted in a fit and proper manner. The purpose of this Statement of Guidance ('Statement of Guidance') is to provide the governing body of a regulated mutual fund ('Governing Body') and its operators (as defined in the Mutual Funds Law (2013 revision)) ('Operators') with guidance on the minimum expectations for the sound and prudent governance of the regulated mutual fund.

1.2 This Statement of Guidance sets out the key corporate governance principles pertaining to the Governing Body and Operators of a regulated mutual fund. This Statement of Guidance is not intended as a prescriptive or exhaustive guide to the Authority's expectations with regard to the governance of a regulated mutual fund.

1.3 The governance structure of a regulated mutual fund must be appropriate and suitable to enable the effective oversight of a regulated mutual fund. The size, nature and complexity of a regulated mutual fund are fundamental factors in determining the adequacy and suitability of its governance framework. Factors determining the size, nature or complexity of the regulated mutual fund could include, but are not limited to: assets under management, number of investors, complexity of the regulated mutual fund structure, nature of investment strategy, or nature of the operations.

December 2013

Application

2.1 This Statement of Guidance applies to all regulated mutual funds as defined by section 2 of the Mutual Funds Law (2013 Revision) (as amended) (the "Mutual Funds Law") and includes funds licensed or administered under section 4(1) or registered under section 4(3) of the Mutual Funds Law ('Regulated Mutual Fund').

Oversight Function

3.1 The Governing Body of a Regulated Mutual Fund is the directing will and mind of the Regulated Mutual Fund and has ultimate responsibility for effectively overseeing and supervising the activities and affairs of the Regulated Mutual Fund.

3.1.1. The Governing Body of Regulated Mutual Fund is the board of directors where the Regulated Mutual Fund is a corporate, the general partners where the Regulated Mutual Fund is an exempted limited liability partnership, and the trustees where the Regulated Mutual Fund is a unit trust.

3.2 The Governing Body should monitor and regularly take steps to satisfy itself that the Regulated Mutual Fund is conducting its affairs in accordance with all applicable laws, regulations, rules, statements of principles, statements of guidance and anti-money laundering or combating terrorist financing requirements, including those of the Cayman Islands and the Authority.

3.2.1 The Governing Body should regularly take steps to satisfy itself that the Regulated Mutual Fund's service providers ('Service Providers') are monitoring compliance with applicable laws, regulations, rules and statements of principle, statements of guidance and anti-money laundering or combating terrorist financing requirements.

3.2.2 The Governing Body should request appropriate information from the Service Providers and/or professional advisors of the Regulated Mutual Fund to enable it to satisfy itself regularly that the Regulated Mutual Fund is operating in compliance with the applicable laws, regulations, rules and statements of principles, statements of guidance and anti-money laundering or combating terrorist financing requirements.

3.3 Where required, the Governing Body shall provide appropriate directions to the Service Providers to rectify any non-compliance with the applicable laws, regulations, rules, statements of principles, statements of guidance and anti-money laundering or combating terrorist requirements.

3.4 The Governing Body should require regular reporting from the Regulated Mutual Fund's investment manager and other Service Providers to enable it to make informed decisions and to adequately oversee and supervise the Regulated Mutual Fund.

Conflicts of Interest

4.1 The Governing Body of the Regulated Mutual Fund and its Operators must suitably identify, disclose, monitor and manage all its conflicts of interest.

4.2 The Governing Body of the Regulated Mutual Fund must document the disclosed conflicts of interest.

December 2013

Governing Body Meetings

5.1 The Governing Body of the Regulated Mutual Fund should meet at least twice a year in person or via a telephone or video conference call.

5.2 Where the circumstances or size, nature and complexity of the Regulated Mutual Fund necessitates it, the Governing Body should meet more frequently than suggested in paragraph 5.1 so as to enable it to fulfil its responsibilities effectively.

5.3 Where necessary, the Governing Body shall request the presence of its Service Provider/s at its Governing Body meetings.

Operators Duties

6.1 The Operator must exercise independent judgment, always acting in the best interests of the Regulated Mutual Fund, taking into consideration the interests of its investors as a whole.

6.2 The Operator must operate with due skill, care and diligence.

6.3 The Operator must make relevant enquires where issues are raised with it on matters fully within the scope of the Operator's responsibility as an Operator of a Regulated Mutual Fund and be satisfied that appropriate and timely course of action is being taken.

6.4 The Operator should communicate adequate information to the Regulated Mutual Fund's investors where it is properly able to disclose.

6.5 The Operator must act honestly and in good faith at all times.

6.6 The Operator must ensure it has sufficient capacity to apply its mind to overseeing and supervising each Regulated Mutual Fund it is an Operator of and

to all matters falling within the scope of its responsibilities as an Operator of each Regulated Mutual Fund. Consequently, before taking on any additional funds, the Operator should always ensure that it is able to perform the functions and duties of an Operator in a responsible and effective manner in accordance with relevant laws, regulations, rules, statements of principles and the provisions of this Statement of Guidance.

6.7 Upon registration of a Regulated Mutual Fund with the Authority, and on a continuing basis, the Operator is responsible for:

6.7.1 Ensuring or receiving confirmation that the constitutional and offering documents of the Regulated Mutual Fund comply with Cayman Islands law, and for licensed funds, the Rule on Contents of Offering Documents;

6.7.2 Ensuring the investment strategy and conflicts of interests policy of the Regulated Mutual Fund are clearly described in the offering documents; and

6.7.3 Ensuring that the offering documents describe the equity interest in all material respects and contains such other information as is necessary to enable a prospective investor to make an informed decision as to whether or not to subscribe for or purchase the equity interest.

6.8 The Operator is responsible for approving the appointment and removal of the Regulated Mutual Fund's Service Providers and the terms of the contracts with each of its Service Providers.

6.8.1 The Operator is responsible for ensuring that its investors and the Authority are notified of any changes to these appointments.

6.9 The Operator retains ultimate responsibility for functions delegated to Service Providers and should regularly monitor and supervise the delegated functions.

6.10 The Operator should review all of its Service Provider contracts to ensure roles and responsibilities are clearly defined and that the responsibilities are clearly divided between each Service Provider. The Operator should make sufficient enquiries to enable it to properly understand the scope and nature of the responsibilities of each Service Provider.

6.11 The Operator must satisfy itself that the various professional Service Providers to whom it has delegated a function/s are performing their functions in accordance with the terms of their respective contracts.

6.12 Upon registration of the Regulated Mutual Fund with the Authority, and on a continuing basis, the Operator of the Regulated Mutual Fund is responsible for regularly assessing the suitability and capability of its Service Providers.

6.13 The Operator should regularly verify or seek confirmation from the Service Providers that they are acting in accordance with the Regulated Mutual Fund's constitutional and offering documents.

6.14 The Operator must regularly monitor whether the investment manager is performing in accordance with the defined investment criteria, investment strategy and restrictions.

6.15 The Operator should, as necessary, and at all material times inform itself of the Regulated Mutual Fund's investment activities, performance and financial position.

6.16 The Operator should review and approve the Regulated Mutual Fund's financial results and audited financial statements.

6.17 The Operator should regularly monitor the Regulated Mutual Fund's net asset valuation policy and that the calculation of its net asset value is being calculated in accordance with this policy.

6.18 An Operator should ensure that it has sufficient and relevant knowledge and experience to carry out its duties as an Operator.

6.19 Each Operator should assess whether it has, together with any other Operator of the Regulated Mutual Fund, sufficient and relevant collective knowledge and experience to perform the duties imposed upon the Operator of the Regulated Mutual Fund.

6.20 Each Operator must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that such an Operator has.

Documentation

7.1 The Operators are responsible for ensuring that a full, accurate and clear written record is kept of the Governing Body's meetings.

7.2 The records of the Governing Body meetings should include:

7.2.1 The agenda items and circulated documents;
7.2.2 A list of attendees present at the meeting and whether that attendance was in person or via telephone or videoconference;
7.2.3 The matters considered and decisions made; and
7.2.4 The information requested from, and provided by, Service Providers and advisors.

Relations with the Authority

8.1 The Operator should conduct the Regulated Mutual Fund's affairs with the Authority in a transparent and honest manner always disclosing to the Authority
a) any matter which could materially and adversely affect the financial soundness of the Regulated Mutual Fund; and
b) any non-compliance with the laws, regulations, rules and statements of principles, statements of guidance and anti-money laundering or combating terrorist requirements applicable, including those of the Cayman Islands and the Authority.

8.2 Where the Operator is uncertain whether to communicate information in accordance with 8.1 to the Authority, it should be prudent and diligent and communicate the information.

Risk Management

9.1 The Operator should ensure it provides suitable oversight of risk management of the Regulated Mutual Fund, ensuring the Regulated Mutual Fund's risks are always appropriately managed and mitigated, with material risks being discussed at the Governing Body meeting and the Governing Body taking appropriate action where necessary.